

Executive Summary

FY04-05 Proposed Budget Highlights	A-8
Economic Assumptions.....	A-9
Community Profile	A-10thru A-11
Goal Setting and Guidelines	A-12 thru A-18
Economic Condition and Outlook.....	A-19 thru A-24
Cash Management	A-25 thru A-29
FY04-05 Expenditure Overview	A-30 thru A-37

FY04-05 Proposed Budget Highlights*

- **Expenditures for all funds** total \$116,535,242, an increase of 4.6 percent over FY03-04
- **General Fund expenditures** are budgeted to **equal** General Fund **revenues**
- **General Fund expenditures** of \$85,887,774, an increase of 8.9 percent over FY03-04
- **General Fund revenues** of \$85,887,774, an increase of 8.9 percent over FY03-04
- **Capital Fund expenditures** for general fund supported projects of \$2,963,765, representing 3.5 percent of general fund expenditures. In addition, historic properties and open space capital projects (\$2,349,000) funded by the general fund via debt financing
- **Proposed real estate tax rate** maintained at **\$.92 per \$100**, which includes 3 cents for the **open space fund**
- Real estate residential **assessments** increased an average of 13.1 percent in 2004, excluding new construction (.5 percent)
- **Assessed value** of all real property increased \$392,342,400 or 11.8 percent in 2004
- **One cent on the real property tax rate** is equivalent to approximately \$382,000
- **Personal property tax** rate maintained at **\$3.29** per \$100
- **Cellular** tax, **cigarette** tax, **meals** tax and **BPOL** rates **unchanged**
- **Market adjustment of 2.4 percent for employees** totaling \$509,127, and public safety salary increases totaling \$379,258, recommended based on parity with surrounding jurisdictions
- **Water** and **sewer** service rates **increase 5 percent**
- **Water** and **sewer connection** fees remain unchanged
- **General Fund balance** at 12.2 percent of general fund expenditures

* *Certain terms used in this document may not be familiar to the reader. A glossary containing definitions for your assistance is included at pp. A-89 through A-95*

Economic Assumptions

The underlying economic assumptions in this budget are:

- **Increase** in overall **residential assessments** due to continuing high level of new construction as well as reassessments in existing housing
- Continued **low vacancy levels** and new retail construction resulting in **increased commercial assessments**
- **Regional economy** experiences moderate growth
- **No reduction in retail sales** in FY04-05 from currently estimated
- **No reduction in estimated personal property** revenue; stabilizing used car values and no reduction due to state actions
- **No further reduction in interest** earned on investments; current levels very low
- **State/Federal funding to remain flat**; no reduction from proposed levels
- **Stable/low unemployment**
- **Inflation rate of no more than 2.5 percent**, impacting City purchase of supplies, materials, contracts and utilities
- **No changes by state** in tax structure reducing or increasing **local revenues**
- **County contracts** for judicial, social services, fire and rescue, refuse disposal and schools to remain within projected increase of **3.7 percent** for non-school contracts and 4.3 percent increase for schools
- **Limited increase in personnel** or levels of **service**
- **No major boundary changes**

Community Profile

City Government

Date of Incorporation	1799
Date of City Charter	1961
Form of Government	Council—Manager
Number of City Positions (FY 04/05 Proposed)	401

Physiographic

Land Area	
Square Miles	6.34
Acres of Public Parks & Open Space	188
Paved – Lane Miles	169
Sidewalks	87

Utilities

Telephone	Verizon
Electric	Dominion Virginia Power
Gas	Washington Gas
Water	City of Fairfax
Sewer	City of Fairfax
Cable	COX Cable

Economic Indicators

Largest Private Employers (December 2003)

SunTrust Bank
Verizon Wireless
Fairfax Nursing Center
Ted Britt Ford
Brown's Automotive Group

Largest Public Employers (December 2003)

Federal Technology Services
City of Fairfax
Fairfax County

City of Fairfax Employment

	<u>2nd Qtr 02</u>	<u>2nd Qtr 03</u>	<u>% Change</u>
Construction	1075	957	-11.0
Manufacturing	125	122	-2.4
Transportation,			
Communications	115	124	+7.8
Trade	4123	4153	+0.7
Finance, Insurance,			
Real Estate	1370	1301	-5.0
Services	8937	9268	+3.7
Government	1394	1553	+11.4
Information	776	712	-8.2
Other	112	102	-8.0

Unemployment Rate

	<u>12/02</u>	<u>12/03</u>	<u>% Change</u>
City of Fairfax	1.6	1.8	.1
Virginia	3.6	3.3	-.2
Northern Virginia	2.6	2.1	-.5
U.S.	5.7	5.6	-.3

Retail Sales (in thousands)

	<u>4th Qtr 02</u>	<u>4th Qtr 03</u>	<u>% Change</u>
City of Fairfax	900,000	950,000	+5.5

Tourism

	<u>12/02</u>	<u>12/03</u>	<u>% Change</u>
Number of Hotel/ Motel Rooms	578	578	0
Occupancy Rate	66.2	67.6	+2.1
Average Daily Rate	\$74	\$72	-2.5

Vacancy Rates

	<u>4th Qtr 02</u>	<u>4th Qtr 03</u>	<u>% Change</u>
Office Space	4.4%	6.7%	+52
Retail Space	2.0%	1.0%	-50
Industrial	.01%	0	0

*New category identified

Taxes**Real Property Tax Rate**

FY 2004: \$.92 per \$100 assessed value

FY 2003: \$.92 per \$100 assessed value

FY 2004 Value of one-cent on the

Real Property Tax Rate Approx. \$382,000

Personal Property Tax Rate

FY 2004: \$3.29 per \$100 assessed value

FY 2003: \$3.29 per \$100 assessed value

City Finances**Bond Ratings**

Moody's Investors Service, Inc	Aa1
Standard & Poor's	AA+

Population

2003 Estimate	22,400
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2000 U.S. Census	21,498
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1990 U.S. Census	19,622
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Households

2003 Estimate	8,390
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2000 U.S. Census	8,035
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1990 U.S. Census	7,362
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Average Household Size

2003 Estimate	2.61 persons
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2000 U.S. Census	2.61 persons
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Age (2000 population)

(1-19)	4,853
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(20-34)	5,117
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(35-64)	8,775
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(64 +)	2,753
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Median Age (2000)	36
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Median Age (1990)	33
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Race and Ethnicity (2000 Census)

White (Non-Hispanic)	72.9%
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African American	5.1%
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Hispanic (all races)	13.6%
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Asian & Pacific Islander	12.2%
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American Indian and Alaskan Native	0.4%
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Total*	100%
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*Percentage column does not sum to the total shown due to rounding; U.S. Census data indicate net international migration for 1990 – 1998 as 9.0%.

Source: U.S. Census Bureau 2000 Census

Median Household Income – 2003 Estimate

City of Fairfax	\$ 75,028
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Northern Virginia	78,523
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2000 U.S. Census – City of Fairfax	67,642
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Registered Voters

January 2004	13,819
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Housing**Housing Units – June, 2003**

Single-family Homes	6,208
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Condominiums*	1,004
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Rental apartments (est.)	1,574
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Total	8,786
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*Townhouse condos are counted as single-family homes.

Housing Units by Occupancy

	Owner	Renter
2000 U.S. Census	69.1%	30.9%

Average Assessed Value (2003)*

All Residential Units	\$ 291,700
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Single-Family Homes	318,305
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Condominiums**	115,247
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*Includes new construction

**Townhouse condos are counted as single-family homes.

Average Market Rents

	2003
Efficiency	\$ 785

1-Bedroom Apartment	837
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2-Bedroom Apartment	1,013
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3-Bedroom Apartment	1,381
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Median Assessed Value of Homes and Condominiums (2003)

Assessed Value	Units	Total Value	Median
Less than \$99,999	1165	\$148,544,700	\$127,506
\$200,000--\$299,999	2918	746,664,200	255,882
\$300,000--\$449,999	2297	802,884,500	349,536
\$450,000 and over	584	332,661,500	569,625

Source: Real Estate Assessor

Goal Setting and Guidelines

The 2020 Commission Report, completed in 1994, remains the City's guide for strategic planning for the future. The aging of the City's population, infrastructure, housing, public schools and business corridors all were identified as major issues that must be addressed for our community to continue to prosper and thrive. One of the important goals of the City's budget is

Planning for the Year 2020

to continue to link the recommendations of the 2020 Commission Report with the proposed expenditures for FY04-05.

In 1998, City Council convened a Livability Task Force to build on the work of the 2020 Commission. The focus of the Livability Task Force was on neighborhood rejuvenation and community outreach. In the FY04-05 budget year, funding is included for a number of Task Force recommendations, as well as for the Open Space Acquisition fund established as a result of the November 2000 advisory referendum.

Most recently, the City has undertaken a full-scale review of its Comprehensive Plan; adoption is scheduled for later this year. As the City's official guide to its future development, the Comprehensive Plan builds on the work of the 2020 Commission and Livability Task Force and has set as its guiding principle to protect, sustain and enhance the desirable qualities of:

Comprehensive Plan

- The City's residential neighborhoods
- The City's centers of commerce
- The "small town character" in Old Town and throughout the City of Fairfax by:
 - o Promoting revitalization in declining neighborhoods and commercial properties
 - o Promoting the replacement of facilities that are beyond reasonable repair
 - o Promoting attractive, traditional design in all new and revitalized facilities
 - o Assuring efficient movement of traffic along safely designed streets

Budget Development Objectives

In developing FY 04-05 budget, priority was given to funding those projects that would most directly impact the goals set forth in the 2020 Commission Report, the Livability Task Force Report, and the proposed Comprehensive Plan. Many of the projects have been on-going for a number of years, but some are more recent. Beyond the standard measures that apply to all decisions to fund or not fund a particular project or function, particularly high priority was placed on funding projects and programs that directly impacted the following FY 04-05 budget objectives.

- Commitment to **exceptional services**
- Strong support and commitment of resources to **education** and **public safety**
- **Reinvestment** in **infrastructure**
- Funding for **neighborhood revitalization/community livability** programs
- Funding for **Old Town** and **Lee Highway corridor** redevelopment initiatives
- Adherence to **prudent fiscal policies**
- Adequate **compensation and benefits** for employees
- Investment in **City facilities** and **programs**
- More resources committed to **historic properties and programs**
- Continued resources committed to **open space** preservation/acquisition
- **Investment** in **water** and **sewer** systems
- Use of **technological advances** to improve City services and programs

The financial and operating strategies used to frame the FY 04-05 budget incorporate a careful review of available funding sources and a thorough analysis of departmental requests. The proposed budget reflects our firm commitment to meet our budget development objectives within the limits of our means. Additionally, the City Council adopted specific guidelines for the preparation of the FY 04-05 budget, and the City has long-standing adopted financial policies. All of these factors are taken into account in preparing the budget, and in all cases, have been accomplished. Adhering to those guidelines, however, means that not all proposals can be funded. Choices have been made and City priorities have been met.

Council Adopted Budget Guidelines

- No reduction in the quality of City services.
Maintains existing service level in all areas.
- Projected revenues must equal or exceed proposed expenditures.
Current estimated revenues are sufficient to support current proposed expenditures.
- Strive to maintain the real property tax rate at no higher than the FY 03-04 rate.
FY 04-05 real property tax rate remains at 92 cents per \$100 of assessed valuation.
- Maintain a General Fund balance equal to approximately 10 percent of the general fund expenditures in conformance with the City Council financial policy.
General Fund balance is 12.2 percent; cash reserves are not used toward budgeted operating expenses.
- Maintain the General Fund CIP transfer at the City Council financial policy level of approximately 5 percent of proposed expenditures.
Budgeted General Fund support of \$2,963,765, not including transfers to the Open Space and Old Town Service District funds or CIP projects funded with debt financing representing 3.5 percent of proposed expenditures.
- No additional personnel unless it would result in a net reduction in anticipated City expenditures. As vacancies occur, all positions to be evaluated against current needs and priorities.
No new full time positions funded by the General Fund; some reallocation in assignment of existing part time positions. Two new positions funded through the Water Fund to meet OSHA and general safety requirements.
- Provide a fair and affordable market adjustment for employees to retain parity with other local governments and if the economic environment allows.
Provides funding for 2.4 percent wage adjustment.

- Insure appropriate level of funding is directed to fund City Council priorities as outlined in Council's proposed goals for 2002-2004:
 1. Preserve and protect the City of Fairfax's "small town atmosphere" by
 - a. Expanding opportunities for citizen involvement in community decision-making.
 - b. Enhancing quality of life measures and amenities with continued emphasis on recommendations of the Livability Task Force.
 - c. Providing unsurpassed user-friendly, customer-focused business practices for all City operations.
 2. Adopt a revised Comprehensive Plan that will reflect development goals that are sensitive to and appropriate for the size and scale of the community.
 3. Finalize and implement current redevelopment and transportation projects:
 - a. Authorize selected developer(s) to proceed with the Downtown Redevelopment Project.
 - b. Lee Highway Corridor Master Plan
 - c. Northfax Gateway
 - d. Fairfax City Regional Library
 - e. George Mason Boulevard
 4. Continue to pursue the recommendations of the 2020 Commission with specific emphasis on:
 - a. Developing a capital financing plan that is responsive to the School Board's Master Plan for school's renovation.
 - b. Adoption and implementation of the Water Treatment Plant Master Plan.
 - c. Determining future use of the John C. Wood facility site.
 - d. Adoption and implementation of the Blenheim Site Restoration Master Plan.
 - e. Senior citizen issues related to housing availability and tax relief.
 - f. Reduction of the impact of increasing traffic through the City.

Funding included for economic development, City facilities, historic properties, schools, open space, and neighborhood improvements; additional studies underway.

- Continue to pursue cost containment strategies.
All programs reviewed annually for efficiency of operations.
- Continue to seek additional funding through external sources.
Pursuing grant funding to extend City efforts in historic preservation, police, fire and rescue, and land use planning.
- Set water and sewer rates at a level sufficient to maintain an appropriate level of cash reserves and still fund necessary system improvements.
Water and sewer rates increase five percent. Extensive system improvements scheduled for the next several years. Water and sewer connection fees unchanged.
- Implement Council agreed-upon green space acquisition.
Budgeted funding to be added to set aside fund established in FY01-02.

Council Adopted Financial Policies

To establish and document a policy framework for fiscal decision-making and to strengthen the financial management of the City, in April 2000, the City Council proposed a comprehensive set of Financial Policies, as detailed below. The goal of these policies is to ensure that financial resources are well managed and available to meet the present and future needs of the citizens of the City of Fairfax. In all cases, these policies have been adhered to in the preparation of the proposed FY 04-05 budget.

Budgeting Policies:

1. The City's annual operating budget, capital budget and Capital Improvement Program (CIP) shall be coordinated with, and shall be in concert with, the City's Comprehensive Plan.
2. The City shall adhere to the following guidelines in preparing, implementing and executing the annual budget:
 - a. The Mayor and City Council shall develop general guidelines for the budget and provide them to the City Manager by November 15.

- b. The Capital Improvement Program shall be considered by the City Council prior to its consideration of the annual budget.
 - c. Where appropriate, revenues related to expenditures shall be reflected in the budget documents.
 - d. The Mayor and City Council shall meet with selected boards and commissions in work sessions as part of the budget deliberations to review budget items concerning areas of interest to the boards and commissions.
 - e. The Mayor and City Council shall conduct a mid-point review of the implementation of the budget.
- 3. Budgeted current revenues must be greater than budgeted current expenditures.
 - a. Significant one-time revenues shall be used only for one-time expenditures.
 - b. Revenues must be increased or expenditures decreased, in the same fiscal year, if deficits appear.
- 4. The target for the General Fund transfer to the Capital Fund shall be at least 5 percent of General Fund expenditures to help insure adequate reinvestment in capital plant and equipment.
- 5. The City shall set utility rates for the Water and Sewer Funds that will insure industry-standard operation of the enterprise functions.

Reserve Policies:

- 1. The target for the General Fund balance shall be, at minimum, 10 percent of General Fund expenditures and, as an upper limit, equal to 45 to 60 days of expenditures (12.5% to 16.7% of annual expenditures).

Debt Policies:

- 1. Debt Service Targets
 - a. Annual debt service expenditures shall be less than 9 percent of annual expenditures.
 - b. Outstanding Debt shall be less than 3 percent of assessed valuation.

2. The term of any bond issue shall not exceed the useful life of the capital project/facility or equipment for which the borrowing is intended.

Revenue/Cash Management Policies:

1. The City shall maintain an aggressive economic development effort in order to lessen the impact of any future real estate rate increases.
2. The City shall maintain a diversified revenue base in order to shelter City finances from short-term fluctuations in any single revenue.
3. The City shall manage its cash in a manner designed to prevent the necessity of utilizing short-term borrowing to meet working capital needs.
4. Annual City revenues shall be projected by an objective and thorough analytical process.
5. The City shall deposit all funds within 24 hours of receipt.
6. Investment of City funds shall emphasize the preservation of principal with safety, liquidity and yield being the primary factors considered.

Accounting/Auditing and Financial Reporting Policies:

1. The City shall take all necessary actions in order to continue receiving the Government Finance Officers Association awards for the budget and for the comprehensive annual financial report (audit).
2. An independent audit shall be performed annually and a management letter received by City Council. City administration shall prepare a response to the management letter on a timely basis to resolve any issues contained in the letter.

Economic Condition and Outlook

A diversified economy is generally more resilient and more stable than one that is heavily concentrated in one or two areas. The City of Fairfax is in a particularly favorable position because its own local economy is relatively diverse and it benefits from its location as part of the Northern Virginia region and from the current priorities in federal spending.

It long has been recognized that the Washington metropolitan area economy is different from that of other area economies. While not “recession proof”, economists cite an economic structure of core industries that is different and less cyclically sensitive, dominated by federal spending and federal procurement with fewer businesses in the manufacturing sector. This core industry structure continues to protect the Washington area, and is an important contributor to our local economy.

Federal Indicators

Federal spending in the Washington region continues to increase. These spending increases are in two primary sectors – outsourcing for technology and professional and managerial services and for the war on terrorism. Businesses that serve these needs continue to move into the City and the Northern Virginia region. Between November 2002 and November 2003, Northern Virginia, with its high concentration of government contractors, picked up 22,000 jobs.

According to recent studies by Stephen Fuller, federal spending in the Washington region accounts for about one-third of the gross regional product (the value of goods and services produced locally). And, while the net number of civil service jobs may be declining, when contract and grant related jobs are included, the number increases. The same Fuller study concludes that...”Federal procurement contract awards to firms located in the Washington area and doing their contract work locally accounted for 43 percent of all federal spending in the area, while federal salaries and wages accounted for 29 percent. Two decades ago, these percentages were approximately reversed.”

Because City residents work in businesses located outside the City and the reverse is true as well, the actions of the federal government have both direct and indirect impacts on the City’s

economy. The effects of federal spending are seen in everything from direct consumer spending to business investment and job growth and employment.

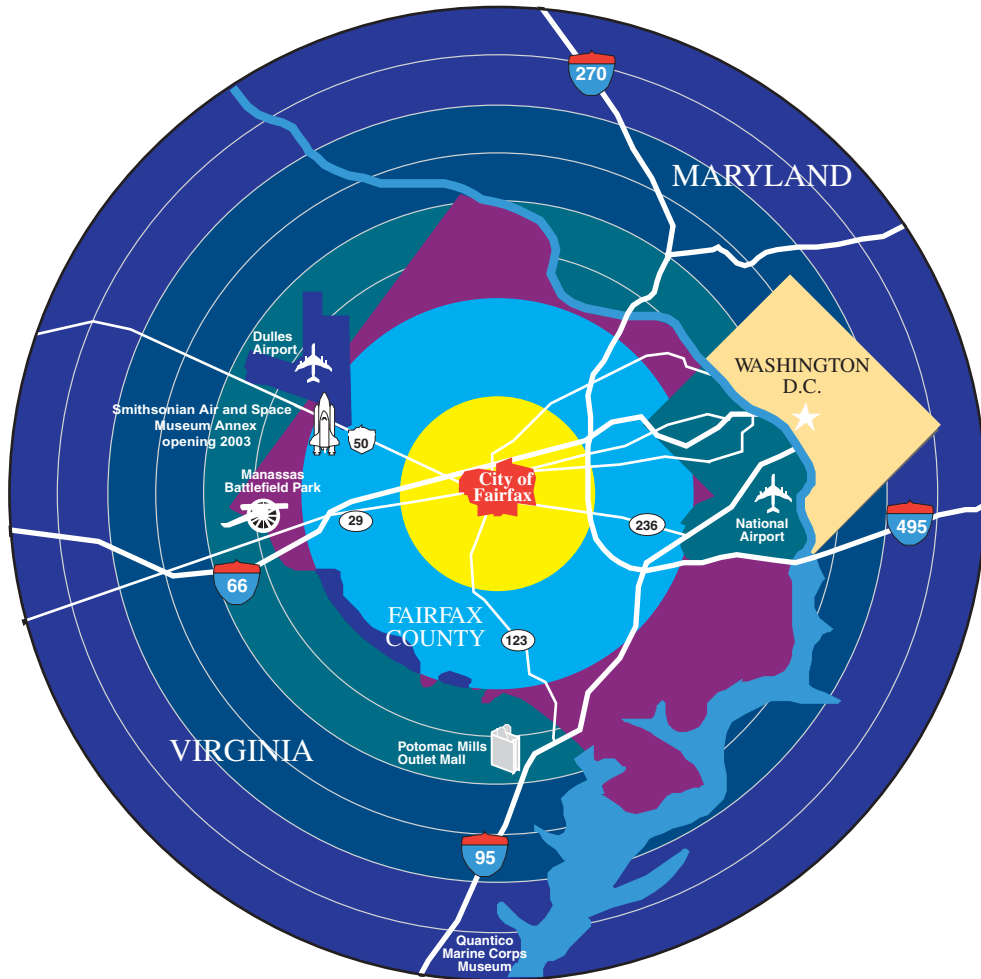
State Indicators

The City also is significantly impacted by state actions. While state tax collections are rebounding after two years of flat or declining tax collections, state officials are also indicating that higher tax collections may not be enough to cover current levels of existing programs. Additionally, last year's state budget was balanced in part with one-time options. That money will not be available again this year.

The General Assembly is considering a number of tax restructuring proposals, some of which may increase state funding. However, equally likely could be level or potential reductions in state aid for transportation, education, law enforcement, and social services, as well as cost shifting to localities for wholly or partially supported programs. Until the state budget is adopted, we must budget state revenues conservatively, which means more or less even with last year's.

Local Economy

The City's central location in Northern Virginia is one of the most significant factors in the strength of its economy.

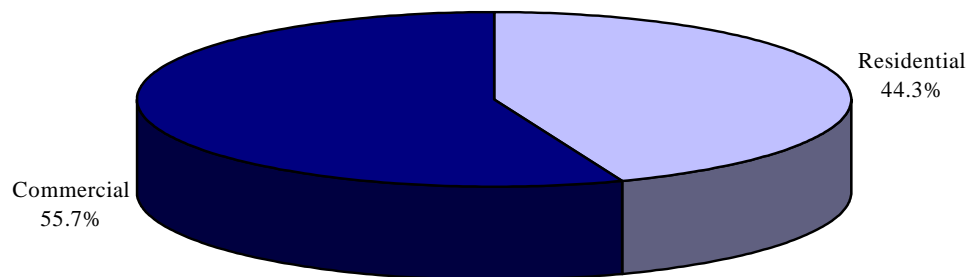


The City of Fairfax is at the crossroads of Northern Virginia's major north/south and east/west highways, and within 30 minutes of both Dulles International and Reagan National Airports. Interstate 66 borders the City to the north and George Mason University is located at its southern border; Routes 123, 29, 50 and 236 all intersect along the City's central business corridor.

Over 300,000 cars pass through the City daily, accounting for much of the commercial revenue generated in the City, particularly sales and meals taxes and, more indirectly, BPOL and commercial assessed values. Many of those not destined for the City but passing through will

stop to shop. Through its planned revitalization of Old Town Fairfax and the Lee Highway corridor, making these areas destinations, the City is hoping to capture an even greater share of these expenditures. This non-residential tax base is why an unusually high percentage of the City's revenue is approximately 55.7 percent in FY04-05, significantly higher than that of some area jurisdictions, will be generated by the commercial sector. This allows the City to maintain the lowest overall tax rate in Northern Virginia, as it spreads the tax burden out to non-residents.

Revenue Generated By
Commercial and Residential Sectors
FY04-05



The economy of the City of Fairfax has regained most of the momentum lost during the economic slowdown of 2000-2002. When this year began, the City's office space vacancy rate was over 8.5 percent; it is now 6 percent and declining. That is a net absorption of 100,000 square feet. The City's office vacancy is much lower than that of other Northern Virginia jurisdictions – the next closest is 15.7 percent, but it is higher than it had been for several years. Retail vacancy is at an all time low – under 1 percent.

Retail sales, one of the most important revenue sources for the City, have recovered at a rate exceeding 10 percent, due to the infusion of new retail outlets and improved same store sales. Restaurant sales have continued to improve, approaching 5 percent increases annually. One final category, Business Professional Occupational License (BPOL) revenue, also has begun a recovery with an increase this year exceeding 10 percent.

The Enterprise Center continues to be a successful project, with several clients on the waiting list. A total of thirteen businesses have now graduated from the Center, up two from last year. The Center is expanding its outlook to include foreign incubator companies. Six Swedish companies have indicated an interest in locating offices in the incubator as a first step in entering the US market. A grant has been applied for that will create additional demand for foreign incubator space, if it gets approved.

A few facts highlight the City's position:

- The City has an inventory of 4 million square feet of office space with a vacancy rate of 6 percent; rental rates are up to \$29 per square foot
- Retail space totals 3.7 million square feet with a vacancy rate of less than 1 percent, and rents in the Lee Highway corridor have broken the \$40 per square-foot barrier
- Industrial space continues to be 100 percent occupied for all 400,000 square feet
- Taxable retail sales for the year will approach the \$1 billion level
- The addition of new restaurant and grocery store properties has resulted in increased revenues from restaurants
- Information technology businesses, over 155 strong, continue to move into the City
- New home construction and the price of new homes have continued to be strong elements in the City's economy. Three projects are nearing completion and have added nearly 300 new homes to the City's inventory, with an average sales price of \$420,000. A single-family home project with 100 homes is now under construction with the base models selling for \$750,000. Another 200 homes are in the early stages of the planning and approval process
- A new office building of 23,000 square feet is in the final stages of the approval process and two other commercial projects are in feasibility studies.
- The redevelopment project in Old Town Fairfax is on track with the selection of a new developer this past fall in a competition that saw eight proposals submitted. The new development plan calls for 90,000 square feet of retail space, 40,000 square feet of office space, a new Library of 40,000 square feet and 60 residential condominiums. This project is hoped to provide the spark for the redevelopment of several other properties in Old Town Fairfax. The private investment is projected at \$65 million and the City will be constructing public projects in support of the redevelopment of another \$13 - \$20 million.
- The City is committed to its plans for the future revitalization of the Lee Highway corridor

The largest revenue generator for the city continues to be the still-increasing local housing values and continued new residential construction. The City's central location

combined with low mortgage rates and a continuing tight supply of available houses have combined to increase real estate values by 13.2 percent in 2003 and by an additional 11.8 percent in 2004. The appreciation in home values and the accompanying increase in home equity combined with low mortgage rates spurred mortgage refinancings, which in turn helped boost consumer spending on remodelings, adding additional value.

The strength of the local housing market, while certainly a positive economic indicator, also is a bit of a double-edged sword, as it illustrates the City's dependence on a major revenue source that has risen dramatically in the past, only to plunge sharply and recover at a very slow pace over a period of years. While rising housing values clearly is a positive, the impact on homeowners is also recognized. Although the City's economic base is more diverse than that of some other jurisdictions, it still is tied to few options to turn to if those tax revenues fall.

The overall revenue picture remains positive for the City. Our economy is diversified. The City has access to a few non-real estate related sources of local revenue, and our local housing market remains strong and shows positive signs that that trend will continue. FY04-05 General Fund revenues are projected to increase by an estimated 8.9 percent over FY03-04. However, the City will face serious challenges in the years ahead as pressures for additional spending outstrip the ability of current revenue sources.

Cash Management

Fund Balance

It is critically important to maintain an adequate fund balance. By financial policies recommended by both the City's financial advisors and our auditors, and adopted by the City Council, our goal is a fund balance equal to a minimum of 10 percent of our General Fund expenditures.

More than being key to maintaining and/or potentially improving the City's bond rating, an adequate fund balance allows the City to cope with revenue shortfalls, to pay for unbudgeted expenditures or unanticipated needs, or to pay for other one-time large expenditures. In FY 03-04, the City was able to pay Fairfax County \$1 million to address a \$2.7 million misallocation by the State of vehicle rental taxes; the remaining balance due will be repaid over ten years. This resolution would not have been possible without the availability of these funds in the fund balance.

In addition to being a sound budgeting practice, the interest earned on the fund balance through sound investing by the City Treasurer is a source of current revenue, \$750,000 in FY04-05, although historic low short-term interest rates continue to significantly reduce this revenue from previous years. Three years ago, City investments earned 4 percent. Current rates average 1.2 percent. That difference is equivalent to two cents on the City's real estate tax rate.

*Fund Balance Minimum
Goal Of 10 Percent*

The adequacy of unreserved fund balance needs to be assessed based on a locality's specific circumstances. In preparing the annual budget, projected revenues must equal or exceed expenditures; we must live within our means and cannot rely on the fund balance to support recurring or operating expenditures. The 2003 Comprehensive Annual Financial Report from the City's auditor stated, "It has always been our recommendation that a government strive to be near the top of (that) range at fifteen percent of operating revenues..." The ten percent goal established by the City is a minimum goal; we should strive for a higher percentage, particularly in view of the increasing debt the City is considering in the next few years.

General Fund Balance -- Proposed Budget

	Amount	Percent of General Fund Expenditures
FY04-05*	\$10,456,564	12.2
FY03-04*	10,456,564	13.0
FY02-03	10,456,564	13.9
FY01-02	9,954,003	14.1
FY00-01	9,576,156	12.9
FY99-00	9,211,876	13.3
FY98-99	8,269,897	13.3
FY97-98	9,106,063	16.3
FY96-97	8,465,278	16.4

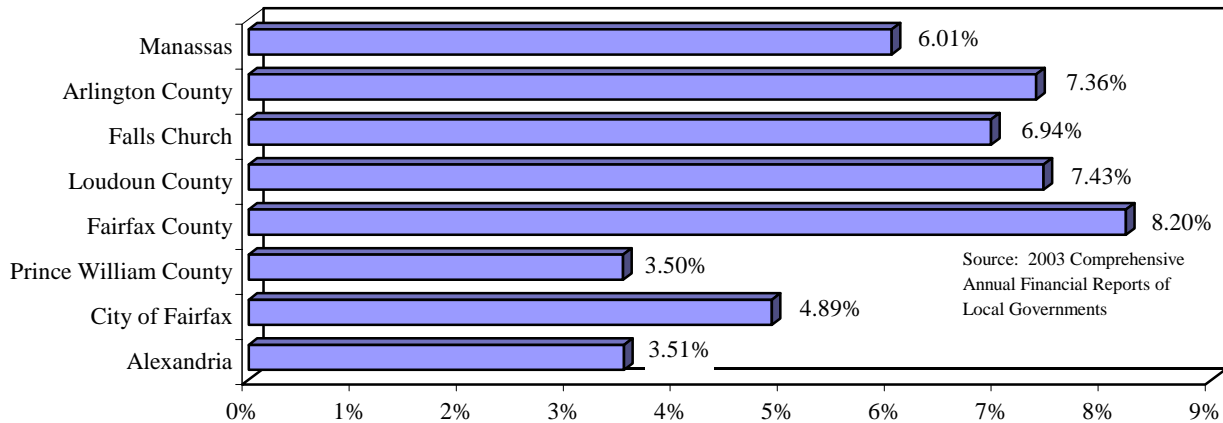
* estimated

We remain in uncertain and somewhat volatile economic times. We recognize that tax rates should not rise merely to build up the fund balance. However, a healthy fund balance can cushion the impact of large scale increased expenditures so that tax increases that still may be necessary do not have to be so steep. Understanding that we need to find a reasonable balance between the need for an adequate fund balance as well as a reasonable real estate tax rate.

Debt Service

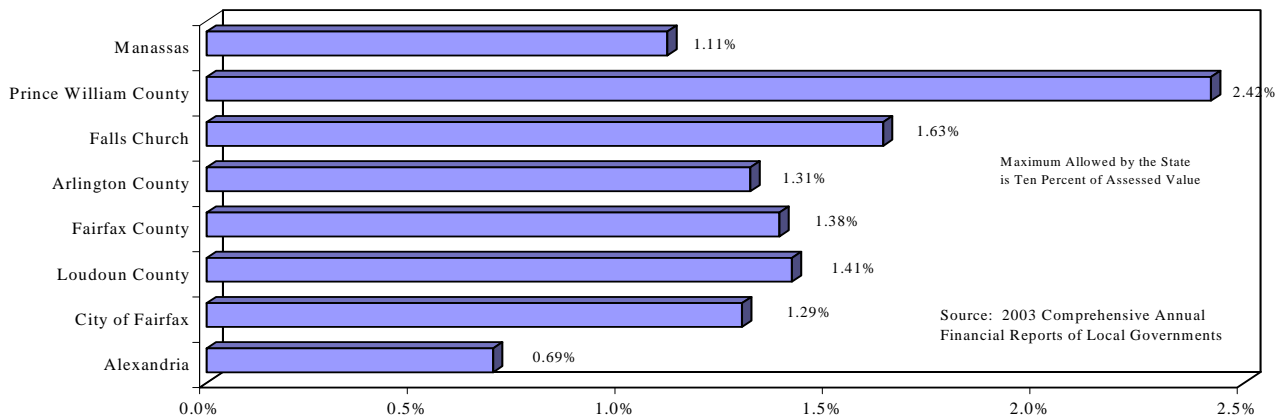
The City currently is repaying bonds for projects to improve City schools, streets, municipal properties and storm drainage. In the past, the City has used bonds sparingly. The City's bond rating for its current general obligation bonds is excellent: AA+ from Standard and Poor's Corporation and Aa1 from Moody's. Because of those high ratings, City bonds are desirable and carry favorable interest rates. We must ensure that our budget actions allow us to retain these high ratings.

Annualized Debt Service as a Percent of General Fund Expenditures



While the City's debt burden still is considered to be moderate – and remains low when compared to that of most Northern Virginia jurisdictions – it has risen and potentially will rise again. Although no debt service payments would be payable in FY 04-05 from an anticipated school bond referendum in November 2004. Debt service costs are up \$941,014 in FY04-05 over FY03-04. This increase is due to anticipated new debt service for open space purchases, Blenheim renovations, and the construction of a new library. This has increased the percentage of General Fund expenditure allocated to repaying debt by 16.6 percent. We also continue to earn interest on the bond funds, but sharply lowered interest rates over the last several years have significantly reduced this amount. The City's financial advisors monitor all outstanding City debt every month to review our options for refinancing in order to reduce City debt costs; a 2003 refinancing resulted in savings of \$110,000 in the Water Fund and a 2004 refinancing will result in \$202,000 in General Fund and \$52,000 in Water Fund savings.

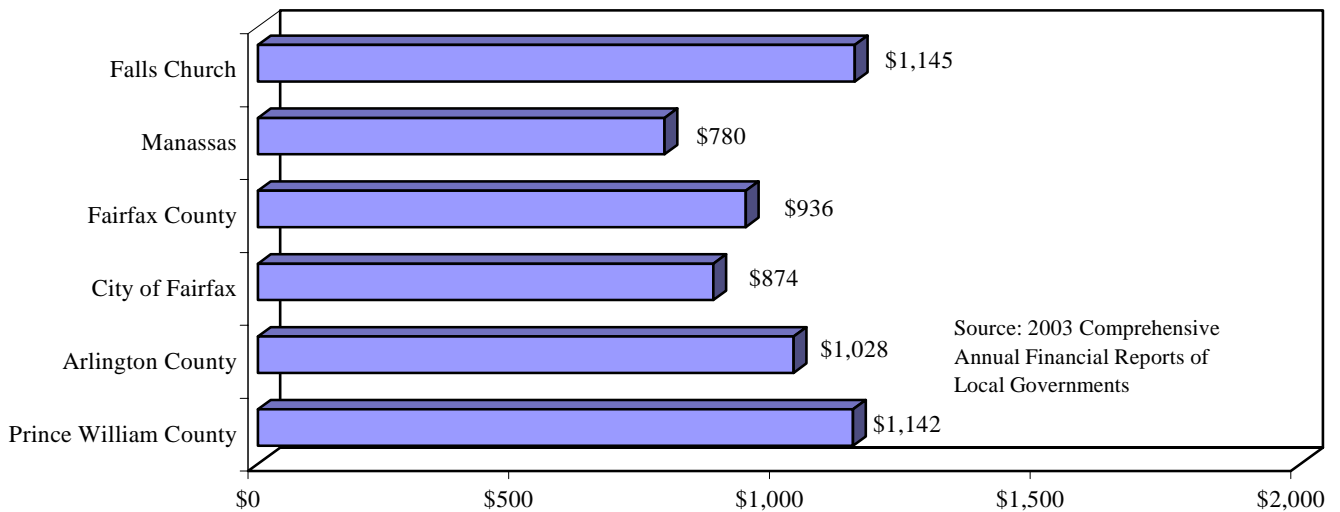
Outstanding Debt as a Percent of Assessed Value*



* Excludes Enterprise Fund Debt

The City's education debt also compares very favorably with that of other area jurisdictions.

Per Capita Education Debt



The City has several potential projects that will require some form of financing. The proposed school bond referendum for Lanier and Fairfax High represents the largest potential project. Additionally, in the upcoming months we will be considering a line of credit or other type of financing to finance additional open space purchases and historic property renovations. The more rapid amortization offered by short-term or private financing in this current interest environment will allow the City to take advantage of current conditions and initiate these steps

for these more long-term projects without the necessity of going to the bond market. The City also continues work on redevelopment projects in Old Town Fairfax and along the Lee Highway Corridor. Both projects represent some form of public/private partnerships that will require bonding and/or other financing in the future.

Short and long term financing represents sound fiscal strategies that allow the City to leverage its resources to its benefit. Again, the City is fortunate because we have a relatively low debt burden; there is room to add debt and structure it to the City's advantage.

FY04-05

Expenditure Overview

The primary responsibility in developing a budget is to balance revenue capacity with service requirements. The continuing uncertain economic picture and a desire to mitigate any increased tax burden on our citizens has resulted in a budget that maintains services and core programs and includes only minimal service enhancements and no new programs.

This is a time when the City needs to re-examine its priorities. Not everything we currently do can continue to be funded and, at the same time, have the City embark on very costly capital projects – particularly those related to schools, historic properties and open space – without either reducing other expenses or significantly increasing taxes. Our revenue growth within existing resources – even if the rise in real estate values continues – cannot provide sufficient revenue for all of these projects.

Although some of the City's expenditures are discretionary in nature, many of the City's largest expenses either are fixed, or in the case of contract expenses that make up 42.9 percent of our budget, outside of our control. Except for these essentially fixed or contract costs, in almost all areas, we actually are reducing our level of expenditures this year, essentially spending less on operating costs. We have followed that course in previous years as well.

The expenditure categories that drive the budget every year are remarkably the same; education, increasing debt service to pay for long-term investments in City facilities, capital outlay, and the occasional expansion in some service or program (everything from CUE buses to expanded security needs to programs for youth and seniors). It is helpful to look at a ten year history of expenses to gain some perspective on where our resources are allocated.

CITY OF FAIRFAX, VIRGINIA
EXPENDITURES BY FUNCTION
FY 95-96 to FY 04-05

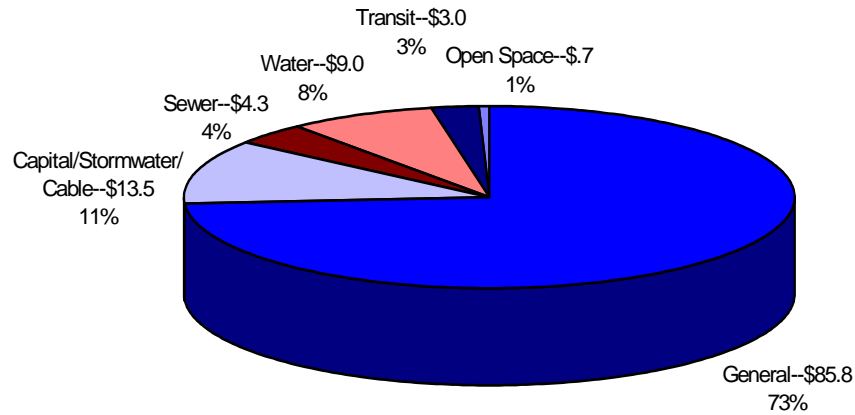
Fiscal Year	Police	Fire & Rescue	Public Works	Social Services	Culture & Recreation	Comm Develop & Planning	General Debt Service	Education	Transfer to Other Funds	Other	Total
1995-96	6,029,321	4,934,592	5,734,242	2,841,947	2,060,782	589,352	770,464	17,326,248	3,458,660	5,565,748	49,311,356
1996-97	6,234,289	5,084,426	5,581,961	2,652,144	2,091,339	526,233	756,109	18,499,859	4,360,869	5,699,936	51,487,165
1997-98	6,396,301	5,177,880	6,166,573	2,715,137	2,178,504	1,131,652	745,903	20,897,335	4,280,637	6,291,533	55,981,455
1998-99	6,383,579	5,157,747	6,218,266	2,925,493	2,319,818	1,166,713	763,869	23,641,677	7,351,350	6,065,354	61,993,866
1999-00	6,576,956	5,357,060	6,606,118	2,705,664	2,482,193	1,374,276	745,738	26,200,992	4,430,677	6,824,403	63,304,077
2000-01	7,286,666	5,998,562	7,194,954	2,963,939	2,876,085	1,579,138	750,473	27,274,957	6,081,546	7,636,009	69,642,329
2001-02	7,376,503	6,093,376	7,230,153	3,309,906	2,859,766	1,676,509	752,818	29,024,104	4,650,928	7,663,833	70,637,896
2002-03	7,762,476	6,585,534	8,032,632	3,437,940	3,013,396	1,610,566	1,310,396	29,735,773	6,480,267	7,416,974	75,385,954
2003-04	8,149,555	7,023,827	8,525,949	3,874,131	3,523,940	1,653,958	3,409,536	32,347,552	4,095,565	7,562,209	80,166,222
2004-05	8,782,171	7,645,935	9,196,051	4,009,855	3,992,451	1,761,929	4,409,050	33,605,542	4,492,353	7,992,436	85,887,774
(1)	2003-04 is estimated.										
(2)	2004-05 is proposed.										

The same pattern that has held true in the past, with a few exceptions, is true for this year, with schools, contract and other non-discretionary expenses the primary factors.

Budgeted Expenditures by Fund

FY 04-05

in Millions



Total FY04-05 Fund Expenditures = \$116,535,242

Budgeted Expenditure Summary

Fund*	Adopted FY03-04	Proposed FY04-05	Percent Change
General	\$ 78,901,112	\$ 85,887,774	8.9
Stormwater	155,000	270,000	74.2
Capital	2,207,856	2,963,765	34.2
Cable	112,000	112,000	0.0
Sewer	3,628,348	4,358,312	20.1
Water	10,778,167	9,022,463	-16.3
Transit	2,696,420	3,064,873	13.7
Open Space	8,550,000	650,000 **	-92.4

*excludes Old Town Service District funds as no expenditures appropriated to date.

** Only \$1,410,000 expended through 2/03; an additional \$650,000 is needed to finance remaining planned acquisitions.

The following chart and discussion briefly examine the major changes in the expenditures from last year's FY03-04 budget.

FY04-05 General Fund Changes

Revenues		Expenditures	
Real Estate Taxes	\$4,067,825	Schools	\$1,257,990
Personal Property Taxes	(595,000)	Contingency – Vehicle Rental Tax	190,000
Other Local Taxes		CIP Transfer	755,909
Sales	1,150,000	Transit Fund Transfer	173,288
BPOL	450,000	General Debt Service	999,514
		Special Events	180,837
Classroom Rental Fee	1,200,000	Ballfield Maintenance	141,609
City County Contract (Library)	783,125	Tax Relief	106,654
Other	(69,288)	County Contracts	152,027
		Health Insurance	430,541
		Market Adjustment	509,127
		Retirement Contribution (VRS)	1,152,826
		Compensation Enhancements	
		Public Safety	362,355
		Debris Disposal	290,500
		City Insurance (Non-Health)	110,467
		Other	173,018
Total	\$6,986,662	Total	\$6,986,662

Schools

School costs represent the single largest expenditure category in the City's budget. This is not unique to the City; in fact, the percentage of the City's budget that goes to education

actually is lower than that of most other area jurisdictions.

School Costs Increase

Nevertheless, because of the percentage of the budget that it represents and because of continuing significant

increases in the number of City students, general increase in tuition costs and capital spending requests, school costs continue to be the primary determining factor in the size of the City's budget and in the tax rate that must be levied to pay for those costs.

Altogether, education costs are up \$1,257,990 over last year. The total cost for schools, \$33,605,542 less school state aid of \$4,866,858 and the county classroom rental change of \$1,200,000, is the equivalent of \$27,555,866, or 76.2 percent of the City's real estate tax income.

The school tuition contract for FY04-05 as proposed by the School Board is up \$1,253,289 over last year's budgeted contract. The total cost of the FY04-05 tuition contract is \$30,338,289; this is a 95.5 percent increase over FY94-95, ten years ago, when tuition contract costs were \$15,520,000.

Open Space

In November 2000, by a two-to-one majority, City voters approved an advisory referendum to increase the real estate tax rate by up to five cents a year for a maximum of five years to provide more money for open space acquisition. Annually since FY01-02, three cents has been set aside, yielding approximately \$3,956,000. Funding at the three-cent level is included in this proposed FY04-05 budget. Three cents will yield approximately \$1,130,000.

To date, Council has purchased two properties through this fund, and initiated condemnation action on additional properties. While the exact purchase price of all properties is unknown at this time, estimates indicate the total costs will consume the total accumulated assets in the Open Space Fund, and likely will exceed the amount if additional funding is not maintained beyond the initial five years. In any case, purchase is likely to occur in advance of all funding being accumulated in the Open Space Fund. Because short term interest rates remain at historic lows, a combination of certificates of participation (COPS) and/or a line of credit has been identified as the most cost effective method of financing these purchases. This will, of course, increase the City's short-term debt level, but is a reasonable and fiscally prudent action.

Debt Service

As was anticipated, debt service costs have increased due to additional projects requiring financing in FY 04-05.

The additional projects that will require financing in FY04-05 generate an increase in debt service of \$941,014. These projects include open space purchases, the Blenheim project and construction of a new library.

Salaries and Benefits

We must continue to invest in our workforce if we are to continue to deliver high quality services and operate efficiently and effectively. The City's compensation plan reflects Council's goal to provide fair and equitable compensation and benefits. Overall, total salary and benefit costs will rise by \$2,658,331 or 10.4 percent over FY 03-04 salary and benefit costs.

Two factors driving up compensation costs are new this year – significant increases in pay for public safety and a significant (albeit possibly short-term) increase in the City's share of costs for the Virginia Retirement System (VRS).

During the past year, the City Council has expressed continuing concern regarding the City's ability to maintain pay equity with other area public safety

agencies. Extensive surveys were conducted and implementation of the proposed compensation changes will move the City from the lower ranks to very close to the top compensation paid by the area's largest and most competitive jurisdictions.

Public Safety Salaries Increase

What we found in doing the surveys was that the City offered competitive salaries at the entry level, but less competitive salaries after that. Additionally, for fire positions, all of the City's fire medics are Advanced Life Support (ALS) Certified; that certification qualifies for additional pay in other area jurisdictions. The same type of premium or bonus pay is true in other jurisdictions that compensate police officers (and other shift workers) with a shift differential pay for scheduled hours worked outside the normal daytime work schedule. We need to take the proposed steps in order to ensure that our public safety departments do not become training grounds for City employees who build a base of work experience and then enter the rank structure of another department that provides greater salary potential than the City. This

is a multi-year process. We will review this again next year and make further adjustments if necessary.

Specific recommended changes to pay plans for implementation in FY 04-05 include the following:

- Fire and Rescue
 - Reclassify/Upgrade 21 positions (\$83,263)
 - ALS Premium Pay of \$4,200 per certified personnel (\$163,800)
- Police
 - Reclassify/Upgrade 22 positions (\$86,292)
 - Shift Differential (\$29,000)

The City also is faced with a sharply increased payment to the Virginia Retirement System (VRS). The City's payment in FY 04-05 is \$2,627,162, up \$1,270,892 over FY 03-04. Locality payments to VRS are based on two year performance by the VRS retirement fund; the FY04-05 and 05-06 rates are being calculated based on fund performance in the very lowest period between June 2001 and June 2003. The market sharply recovered after that and, assuming it continues to perform as predicted, locality rates may well drop again when the next two year calculation period is completed.

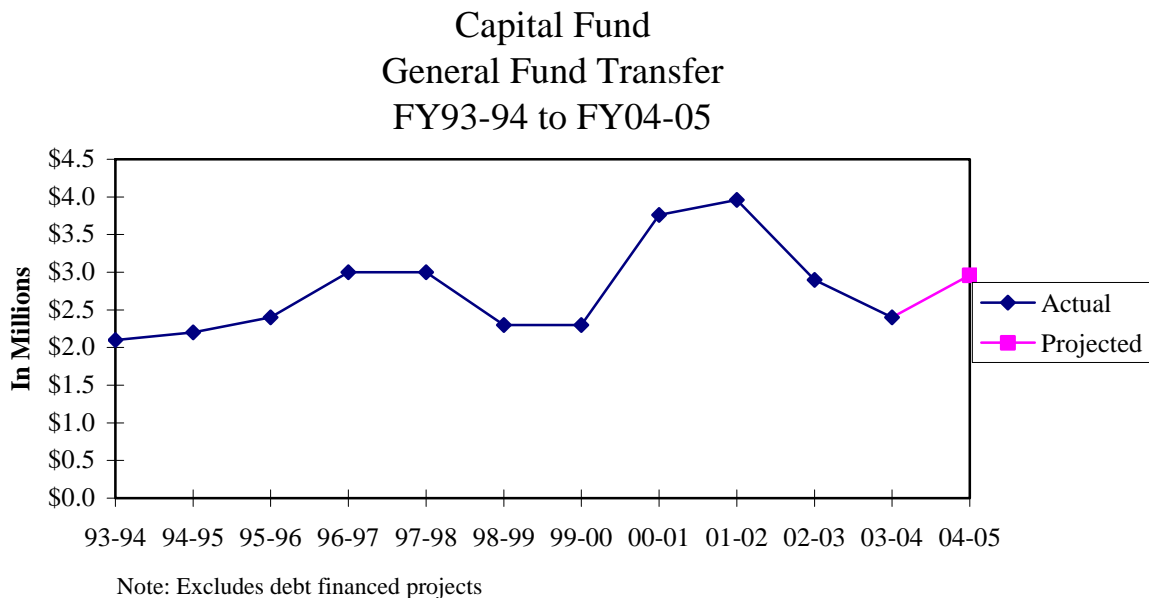
A proposed 2.4 percent wage adjustment maintains the City's overall salary position and allows pay scales for all employees to remain competitive with the market. It is based on a formula that gives equal weight to the Employment Cost index, wages and salaries (ECI) and to the Consumer Price Index (CPI). The ECI is the rate of inflation of wages and the CPI is the rate of inflation of consumer products and services.

As has been the case for a number of years, health insurance costs have increased, although this cost increase is shared by employees. A few non-public safety reclassification actions also are being taken to maintain parity with surrounding jurisdictions and ensure the City can retain specialized personnel in selected positions. However, this has minimal effect on the overall cost of salaries.

Capital Improvement Program

Capital program management covers three basic areas – constructing projects, maintaining them once they are built, and planning for the future. When budgets are limited,

equipment purchases and large maintenance efforts often are delayed. These needs cannot be deferred indefinitely without long-term consequences. The City remains committed to ensuring adequate support for protection and enhancement of capital resources, and that is reflected in Council's financial policy to transfer funds equal to five percent of the General Fund to the Capital Fund.



The CIP included in this proposed budget requires a general fund transfer of \$2,963,765 from the General Fund or 3.5 percent. The General Fund will also service the debt financing of several CIP projects. Combined, the CIP projects funded by a general fund transfer and debt financing exceed the financial policy guidelines of a transfer of not less than five percent that the City Council established.

In FY04-05, while we do maintain the overall level of General Fund support to the Capital Fund, in order to balance the budget many projects originally included in the Capital Improvements Program for FY04-05 presented to the City Council in January had to be postponed or reduced in scope. A total of \$1,905,179 in reductions was required in order to balance the City's revenue with its expenditures along with alternative financing for \$2,329,055 of the original projects.

